No. 95-1492

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

ERNEST L. AKERS, *et al.*,

Petitioners,

vs.

VALFRID E. PALMER, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS

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COUNTERSTATEMENT OF THE QUESTION PRESENTED

Whether the court of appeals, in affirming the district court's granting of summary judgment, correctly held that Defendants' actions in creating and establishing the terms of an ESOP constituted purely business decisions made in the course of performing "settlor" functions, not actionable under ERISA.

PARTIES

Petitioners' listing of the more than 200 Appellants before the Sixth Circuit is incorrect and incomplete.

Petitioners' listing of the Appellees is also incorrect. The correct listing is: Valfrid E. Palmer, Francis J. Comiskey, Donald H. McKinnon, Eugene Callan, William Milanese, Edward Gold, Robert Fuller, Louis Ferrara, Kenneth Easterday, Ron Cole, M. Farkas, D. Daniels and Alco Gravure Industries, Inc.

STATEMENT UNDER RULE 29.6

Respondent Alco Gravure Industries, Inc. is indirectly a wholly-owned subsidiary of Quebecor Printing Inc., a publicly-owned Canadian corporation.

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STATUTES INVOLVED

Besides 29 U.S.C. § 1104(1) (quoted at Petition, 2), the Sixth Circuit opinion at issue here involved 29 U.S.C. § 1106(b), which provides, in pertinent part, as follows:

> A fiduciary with respect to a plan shall not --
>
> (1) deal with the assets of the plan in his own interest or for his own account, [or]
>
> (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries. . . .

29 U.S.C. §1106(b)(1)(2)(1988).

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS

Respondents, Valfrid E. Palmer, Francis J. Comiskey, Donald H. McKinnon, Eugene Callan, William Milanese, Edward Gold, Robert Fuller, Louis Ferrara, Kenneth Easterday, Ron Cole, M. Farkas, D. Daniels and Alco Gravure Industries, Inc., submit this Brief in Opposition to

the Petition for a Writ of Certiorari. For the reasons set forth below, this Court should deny the Petition.

COUNTERSTATEMENT OF THE CASE

(A) Course of Proceedings Below

The opinion of the Sixth Circuit at issue here arises out of two cases consolidated below. The older of the two cases, *Akers v. Palmer* (District Court Case No. 91-2054 H/B; Appellate Court Case No. 94-5740), was filed on January 14, 1991 ("*Akers I*"). In *Akers I*, the Petitioners alleged that they were former employees of Alco Gravure, Inc. ("Alco") who were participants in the Alco ESOP. They asserted claims for violation of Sections 404 and 406(b)(1) and (2) of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1104 and 1106(b)(1) and (2)(1988), against Defendant McKinnon and the other members of the Board of Directors of Alco Gravure Industries, Inc. ("Alco Industries"), as well as Alco itself and other Defendants not pertinent here. (JA[1] 13.)

All the Defendants in *Akers I*, except Defendant McKinnon, were dismissed for failure to serve process. This Order of dismissal was entered on September 30, 1992.[2] (JA 119.)

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[1] "JA" refers to the parties' Joint Appendix in the court of appeals, a copy of which has been filed with the Clerk of this Court.

[2] Petitioners never challenged this Order on appeal.

On March 25, 1993, Petitioners filed a second action, *Akers v. Alco Gravure Industries Inc.* (District Court Case No. 93-2288 H/N; Appellate Court Case No. 94-5743) ("*Akers II*").

The claims in *Akers II* (as in *Akers I*) arise in the context of the January 12, 1988 sale of Alco Industries. A requirement of the purchaser, for the sale to be effected, was that the ESOP Plan and the ESOP Trust be terminated and that the purchaser be the sole stockholder. These and the other undisputed facts underlying the claims are set forth at pages 4-10 below.

By Order dated September 30, 1993, the district court granted Defendants' motion, dismissing Petitioners' claims in *Akers II* as barred by the statute of limitations. In reaching its decision, the district court held that Petitioners had failed to plead allegations of a "fraudulent scheme" with sufficient particularity.

Under the three-year statute of limitations applicable to non-fraud ERISA claims, the Petitioners' claims were untimely. (JA 308.)

On Petitioners' Motion For A New Trial Or To Alter Or Amend The Judgment pursuant to Fed. R. Civ. P. 59, by Order dated November 17, 1993, the district court reinstated *Akers II* as to McKinnon, noting that, since he had been served with process in *Akers I*, the limitations period had been tolled as to him. The Order went on to consolidate *Akers I* and *Akers II* as concerning identical questions of law and fact. (JA 444.)

On February 14, 1994, McKinnon, being the only remaining Defendant in the consolidated action, filed a Motion for Summary Judgment. (JA 125.) In his motion, McKinnon contended that Petitioners failed to show any genuine issue of material fact which would warrant a trial. By Order dated April 28, 1994, the district court granted summary judgment in favor of McKinnon and closed the case. (Petition, A-13 to A-23.)

Petitioners appealed the district court's granting of summary judgment for failure to state a claim under ERISA.[3] On December 11, 1995, the Court of Appeals for the Sixth Circuit affirmed, holding that Petitioners had failed to state a claim under ERISA, because the transactions challenged were not fiduciary acts covered by the statute.[4] (Petition, A-2.)

(B) Statement of Facts

In their statement of facts, and throughout their argument for granting the writ (Petition, 4 to 13), the Petitioners misrepresent the facts in this case by collapsing events which occurred at different times and by misstating or omitting essential details. The following is the accurate statement of facts which was expressly admitted by Petitioners in responding to McKinnon's Statement of

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[3] Petitioners also appealed the district court's dismissal of their Complaint for failure to plead fraud with particularity, and the Court's denial of relief from judgment under Fed. R. Civ. P. 59(e).

[4] Because it found that Petitioners failed to state a claim under ERISA, the court did not address the remaining procedural aspects of Petitioners' appeal. (Petition, A-2, n. 1.)

Material Facts submitted on summary judgment to the district court. (JA 132 to 138; JA 453 to 454.)

Alco Industries is a Delaware corporation which was organized in March 1981. In April 1981, 2,600 shares of Alco Industries common stock, constituting all of the outstanding stock of the corporation, were sold to eleven founding individuals at $60 per share. Defendant McKinnon was one of the eleven individuals.

Under Alco's purchase plan and as a condition to the financing, the primary financing bank required the company to form an ESOP.[5]

Alco is a wholly-owned subsidiary of Alco Industries. On May 13, 1981, Alco acquired through merger a printing company, a subsidiary of Macmillan, Inc.

Later in 1981, Alco Industries and Alco established the ESOP Plan and the ESOP Trust (together, the "ESOP") as a stock bonus plan. Virtually all employees of the Macmillan subsidiary after the merger with Alco were eligible participants in the ESOP.

The ESOP Plan and Trust were embodied in and governed by separate written instruments:

(a) Under Section 12.03 of the ESOP Plan, Alco Industries had the right, at any time, to terminate the ESOP.

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[5] This fact is undisputed (*see* Petition, A-3), but it was not in the statement of facts which was submitted by McKinnon to the district court.

(b) Section 11.05 of the ESOP Plan provided that the ESOP Plan would be administered by a committee composed of individuals appointed by the Board of Directors (the "ESOP Committee"). Under Section 5.04 of the ESOP Plan, the ESOP Committee had the authority to direct the Trustee to sell shares of Company stock.

(c) Under Section 4.02 of the ESOP Plan, the funding of the ESOP was by discretionary employer contributions; there was no requirement under the ESOP Plan that the employer make any contribution to the ESOP. Any contribution by the employer was at the discretion of the employer, exercised by its Board of Directors. The ESOP Plan did not require the Board of Directors to advise participants whether, or in what amount, it intended to make a contribution to the ESOP.

(d) Under Section 4.03 of the ESOP Plan, no participant therein was permitted to make any contribution to the Plan.

All contributions to the ESOP that were ever made were made in newly-issued stock of Alco Industries, the number of shares determined by a valuation of their fair market value made by independent appraisers in accordance with the provisions of the Internal Revenue Code and Revenue Rulings thereunder. *These shares constituted the only shares of Alco Industries stock which the ESOP Trust ever held.*

Historically, the Board decided to make a contribution after the close of Alco Industries' fiscal year (which ended December 31) for that fiscal year; for example, in February 1982, a contribution to the ESOP was made for 1981.

In every year for which contributions were made, 1981 through 1986, Alco Industries had a net operating profit.[6]

Alco Industries' certified financial statement prepared by Arthur Andersen & Co. shows that, for 1987, Alco Industries did not have a profit; it had a net loss before taxes of $518,112.

The Board declined to make a contribution to the ESOP for the year 1987.

In 1987, a subsidiary of Maxwell Communications, Inc. ("Maxwell") contacted the Board of Directors of Alco Industries and offered to purchase all of the outstanding capital stock of Alco Industries from its shareholders.

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[6] The following contributions were made to the ESOP (in round figures):

For the year ended 12/31	*Pre-tax, pre-contribution profits (losses)*	*Amount of ESOP Contributions*	*No. of Shares Contributed*
1981	$ 2,600,000	$2,491,200	288
1982	$ 3,377,000	$3,007,000	299
1983	$ 8,703,000	$5,326,000	339
1984	$11,349,000	$6,032,000	349
1985	$ 8,026,000	$4,605,000	277
1986	$ 1,618,000	$ 319,000	22
1987	($518,112)	-0-	-0-

(JA 157.)

The senior management of Alco Industries was in favor of such a sale and negotiated with Maxwell for the highest possible price. One of the terms insisted on by Maxwell was that upon closing, the ESOP Plan and Trust be terminated and there be no minority stockholders remaining.

A letter of intent was entered into with Maxwell at the end of October 1987 contemplating a closing prior to December 31, 1987. On October 30, 1987, Valfrid Palmer, who was at the time President of Alco Industries, issued a memorandum addressed to Alco's employees (including Petitioners) informing them of the proposed purchase by Maxwell and the reasons why the proposal was being considered.

At that time, McKinnon was a member of the Board of Directors of Alco Industries together with Palmer and Francis Comiskey, Jr. (who were officers), and Messrs. Eugene Callan, a banker, and William Flynn, the Chairman of the Board of Mutual of America Life Insurance Company. Callan and Flynn were outside directors and did not own any Alco Industries shares.

Also at that time, McKinnon was a member of the ESOP Committee together with Palmer and Comiskey. All three were major shareholders of Alco Industries and stood to profit if the sale to Maxwell were consummated; on November 5, 1987, McKinnon, Palmer and Comiskey resigned from the ESOP Committee. They were replaced by Callan and Flynn.

As sole members of the ESOP Committee, Callan and Flynn engaged separate legal counsel and retained A.G. Edwards & Sons Inc. ("A.G. Edwards"), an independent

investment banker, to evaluate the fairness of Maxwell's offer. The opinion of A.G. Edwards was that the price Maxwell was prepared to pay was fair; the opinion showed that Maxwell's price was more than twice the fair market value of the shares. Based on this opinion and in accordance with the provisions of the ESOP Plan, the ESOP Committee instructed the Trustee to accept the offer of Maxwell and to sell to Maxwell all of the Alco Industries stock owned by the ESOP Trust.

On December 15, 1987, Palmer issued a memorandum addressed to Alco's employees (including Petitioners) informing them that agreement was reached on all major open items in the sales contract with Maxwell and that the sale of stock was scheduled to take place during the first week of January.

At no time was any corporate action taken resulting in the sale of shares to Maxwell which required a vote by the stockholders. Each stockholder of record made its own determination whether to sell its shares to Maxwell. At no time was there any issue presented to the participants in the ESOP for their vote with respect to the sale to Maxwell, nor was there any corporate action taken that would require their consent.

The sale to Maxwell by every single stockholder of Alco Industries (including the ESOP Trust) was consummated effective January 12, 1988. All shareholders in Alco Industries received precisely the same amount for their shares ($23,311 per share).

In January 1988, the ESOP was formally terminated in accordance with its terms. The ESOP Trust thereafter distributed to all participants, including Plaintiffs, their pro-

rata share of the proceeds of the sale of the ESOP Trust's stock to Maxwell.

REASONS FOR DENYING THE WRIT

THE DECISION OF THE SIXTH CIRCUIT IN THIS CASE IS NOT IN CONFLICT WITH A DECISION OF ANOTHER COURT OF APPEALS.

A. Petitioners Mischaracterize the Decision of the Sixth Circuit as Insulating Self-dealing by ERISA Fiduciaries From Judicial Review.

Petitioners' do not accurately present the holding of the Sixth Circuit. Contrary to the mischaracterization in the Petition, the Sixth Circuit did not sanction self-dealing by ERISA fiduciaries, did not hold that a self-dealing transaction is acceptable where the ESOP makes a profit, and did not adhere to any notion that self-dealing by a fiduciary is insulated from judicial review. Rather, the Sixth Circuit found that "none of the actions of which [Petitioners] complain is a fiduciary act under ERISA." Indeed, the Court explicitly concluded that the conduct of McKinnon was not fiduciary and that the Petitioners' characterization of the actions of the Alco Board as fiduciary, because the Board supposedly benefitted itself "at the expense" of the ESOP beneficiaries, was factually wrong as well as erroneous in law. 71 F.3d at 232. Petitioners' characterization of the decision rests on mere assertions (71 F.3d at 230; Petition A-

7) that Petitioners cannot prove because they directly contradict the undisputed, admitted facts in this case. A fair reading of the Sixth Circuit opinion confirms this.

For example, in a futile attempt to concoct a transaction covered by ERISA, Petitioners argue that the ESOP *purchased* shares and that the purchase was part of Defendants' buyout from Macmillan in 1981. (Petition, 8.) But as the Sixth Circuit, finding that argument "strained, disingenuous, and wholly meritless," correctly noted,

> The ESOP did not "purchase" anything, and plaintiffs offered no evidence other than their own assertions to support their claim. Rather, the shares transferred to the fund served as an initial contribution [made in 1982], giving the ESOP benefits worth over $2,400,000. The trust acquired no debt to obtain the shares, nor were there any plan "assets" used to "purchase" the shares. To be sure, the shares themselves constituted the original plan assets. *They were, in essence, a gift from the employer to the employees.*

71 F.3d 226, 230 (6th Cir. 1995); Petition, A-6 (emphasis added).

Petitioners place great weight on their argument that it must have constituted self-dealing, and thus be a breach of fiduciary duty under ERISA, for the Respondents to have made a geometric return on their investment while the ESOP "merely doubled its money." The Petitioners disregard completely the finding below that neither they nor any other participant in the ESOP made any investment whatsoever in

the ESOP, and that McKinnon and the other founding individuals are the only ones who ever paid *anything* for their shares in Alco Industries.

Moreover, the purchase of Alco Gravure shares by McKinnon and the other founders in 1981 took place before the ESOP was established or anyone appointed its fiduciary and long before any contribution was made by the employer in 1982. As the Sixth Circuit recognized,

> Plaintiff would have this Court apply ERISA to company actions *prior* to the creation of an employee benefit plan. We have found no authority, nor have plaintiffs offered any, to support such an extension of ERISA.

Id. (emphasis in original).

The court of appeals specifically rejected Petitioners' allegation, repeated before this Court, that because McKinnon was a founding member of Alco and voted to create the ESOP and to fund it with 288 shares valued at their fair market value, he thereby was a fiduciary:[7]

> Plaintiffs advance no authority justifying extending ERISA fiduciary standards to govern the conduct of a company in its decision as to whether and on what terms it should create an employee benefit plan.

71 F.3d at 231; Petition, A-10.

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[7] The valuation mandated by the IRS for contributed shares reflects the limitation on available deductible expenses for the employer. *See* I.R.C. § 404. It in no way indicates that a sale of shares to the ESOP has taken place.

As the court of appeals reasoned,

> Because an employer has no affirmative duty to create a benefits plan for its employees, *Moore v. Reynolds Metals Co. Retirement Program*, 740 F.2d 454, 456 (6th Cir. 1984), *cert. denied*, 469 U.S. 1109, 105 S.Ct. 786, 83 L.Ed.2d 780 (1985), only actions respecting the administration or management of plan "assets" are subject to fiduciary standards. *See Musto v. American General Corp.*, 861 F.2d 897, 911 (6th Cir. 1988), *cert. denied*, 490 U.S. 1020, 109 S.Ct. 1745, 104 L.Ed.2d 182 (1989). That is, a company is only subject to fiduciary restrictions when managing a plan according to its terms, but not when it decides what those terms are to be. *Id.* ERISA is simply not involved in regulating conduct affecting the establishment of a plan or with its terms. *Moore*, 740 F.2d at 456. "In particular, courts have no authority to decide which benefits employers must confer upon their employees ...", *id.*, or to review a plan's provisions for reasonableness. *Sutter v. BASF Corp.*, 964 F.2d 556, 562 (6th Cir. 1992). Rather, these decisions should be left to the marketplace or to federal legislation. *Moore*, 740 F.2d at 456. Simply put, "ERISA's concern is with the elements of a plan and its administration *after* it has been established..." *Musto*, 861 F.2d at 912 (emphasis added) (citation omitted).

71 F.3d at 230; Petition A-7.

In no authority cited by the Petitioners has a decision of another circuit been in dispute with the finding of the Sixth Circuit.

B. The Cases From Other Circuits Cited by Petitioners Involve Administration of an ESOP Plan, Including Misuse of ESOP Assets, Which Did Not Occur Here.

The cases cited by Petitioners from other courts of appeals, in particular, *Amalgamated Clothing and Textile Workers Union, AFL-CIO v. Murdock*, 861 F.2d 1406 (9th Cir. 1988) and *Eaves v. Penn*, 587 F.2d 453 (10th Cir. 1978), dealt with transactions involving administration of trust assets, and specifically, misuse of those assets. They are not in conflict with the holding of the Sixth Circuit in this case:

> In this case, there is no allegation that Alco breached its duties to the beneficiaries in its administration of the ESOP.

71 F.3d at 229; Petition, A-6. On the undisputed facts in this case, Petitioners cannot prove any transactions involving the ESOP Trust assets or any facts analogous to the facts of *Amalgamated* or *Eaves*.

The plaintiffs in *Amalgamated* claimed that one of the plan fiduciaries influenced the other plan fiduciaries to use plan assets to acquire shares in two companies he controlled. He then used his control interest to "greenmail" the target companies into buying back their stock from him and the trust at a substantial premium, resulting in the trust having a surplus. Subsequently, he caused the plan to be amended to provide that on termination, any surplus was to be paid to him. Thereafter, he terminated the plan and received the

surplus. Plaintiffs sought to recover the surplus for the plan participants.

Amalgamated did not involve the creation of a plan, but rather the abusive mismanagement of a plan's existing assets. The fiduciary put at risk for his own benefit assets of the plan. Because of the leverage he gained by manipulating the assets of the plan (in being able to greenmail other companies) the individual profited by obtaining premiums attributable to this leverage. Moreover, whereas the plan initially was entitled to the benefit of any premium generated by such dealings, the fiduciary caused the plan to be amended to provide that such premium would be paid to him personally. The court's decision is replete with references to the disgorgement of ill-gotten profits, constructive trusts to protect the beneficiaries, and remediless victims of the fiduciary's fraud. In a word, the *Amalgamated* case, unlike the instant case, involved the mismanagement of plan assets rather than management's ability to create and terminate a plan without becoming an ERISA fiduciary.

Similarly, *Eaves* involved transactions with an ESOP trust. The defendant ESOP trustee, with the intent to obtain sole control of a company (whose assets he later used for his other businesses), caused the trust to purchase 97% of the shares of the company. Through such abuse of the trust assets coupled with his purchase of the remaining shares of the company with funds he borrowed from the company, the defendant obtained the legal title to all of the outstanding shares of the company thereby effecting a buyout for his benefit. The court concluded that, by acting in his own interest rather than the interests of the trust, the trustee violated his fiduciary duty to the trust. *Eaves*, 587 F.2d at 459-60.

The Tenth Circuit in *Eaves* also considered whether that same defendant, by recommending, designing and implementing a change from a rich profit-sharing plan to an ESOP, was bound by fiduciary standards. The Tenth Circuit concluded that he was, because his conduct amounted to rendering investment advice, one of the express circumstances defining a fiduciary under ERISA (*see* 29 U.S.C. §1002(21)(A)(1988)) and that, being a statutory fiduciary, his advice was not for the exclusive purpose of providing benefits to participants, but to facilitate defendants' control of the company. *Eaves*, 587 F.2d at 458. This case follows the same line of judicial reasoning as was followed in *Amalgamated*: the mismanagement of plan assets by a fiduciary is not a purely settlor function and is not beyond ERISA liability.

This Court as recently as four weeks ago recognized the significance of the distinction between performing purely settlor functions and the management or administration of plan assets within the meaning of ERISA. In *Varity Corp. v. Howe*, 64 U.S.L.W. 4138 (1996), this Court rejected the argument of the employer-administrator that it was not acting as a fiduciary when it significantly and deliberately misled the beneficiaries of the plan to transfer their interests to an insolvent company. 64 U.S.L.W. at 4142. The district court had found that the employer-administrator intentionally deceived participants in the plan by connecting statements concerning plan benefits with statements known to be false concerning the viability of the insolvent transferee company. This Court concluded that this conduct constituted the administration of the plan rather than the employer's performance of a purely settlor function. Such conduct was fiduciary. The employer-administrator was exercising "discretionary authority" respecting the plan's "management" or "administration" when it misled the plan beneficiaries. *Id.*

The Court then proceeded to consider the requirement of ERISA that a fiduciary "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries" (29 U.S.C. §1104(a)(1988)). It concluded that the employer-administrator had not done so. 64 U.S.L.W. at 4142.

Varity, like *Amalgamated* and *Eaves* involved administration of plan assets, and not purely settlor functions. These decisions do not conflict with the decision of the Sixth Circuit in this case. As noted above, the Sixth Circuit explicitly found that there was no allegation that Alco breached its duties to the beneficiaries in its administration of the ESOP. 71 F.3d at 229; Petition, A-6. The court held that the Petitioners' characterization of the actions of Alco's Board as fiduciary conduct (because the Board allegedly somehow benefited itself at the expense of the trust beneficiaries) was factually erroneous. 71 F.3d at 226; Petition, A-6. It rejected Petitioners' principal argument that self-dealing was somehow involved (and thus a breach of fiduciary duty under ERISA) for the founders to have made a geometric return on their investment while the ESOP merely doubled its money -- seven years after the Alco established the ESOP. 71 F.3d at 229; Petition, A-5.

CONCLUSION

Because of the absence of conflict among the circuits, we request that the Petition for Certiorari be denied.

Respectfully submitted,

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